State Taxation of Nonresident Foreign Nationals Under International Law

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Abstract

The United Nations Model Convention on Double Taxation is the current international standard by which foreign national nonresidents are taxed. This model convention was developed specifically to address the problem of subjecting foreign nationals to being taxed from the same activity in the country of citizenship and the country of residence. The model serves as a template for a treaty between any two countries, which are referred to in the model convention as "Contracting States."

This model convention also specifically applies to students studying abroad. The United States is a party to many tax treaties including treaties with the countries of China and India which serve as the basis for taxation of nonresidents who are citizens of these countries.

Purportedly, the several states in the U.S. are not bound by the terms of these treaties. The author believes this premise to be erroneous which is the basis of this research.

U.S. Law and Treaties

Individual states in the U.S. are not free to enter into treaties with foreign countries. Section 10 of the U.S. Constitution specifically prohibits states from doing so. It is the federal government alone which can represent the several states in treaties. The several states are bound by the terms of the treaty.

Unlike other areas of the law, treaties are not subject to common law analysis or government agency interpretation. The documents "speak for themselves" making it critical to clearly define important terms within the treaty. Further, any contradicting terms between an international treaty and federal law is resolved in favor of the treaty when applicable.

The major portion of the treaties under the model convention on double taxation serve as the authoritative basis to tax nonresidents based on the origin of the source being taxed (income, gain, royalty etc.). The author asserts that, in the absence of any authority enumerated within the tax treaty, there is no legal basis upon which to tax.

The China and India Treaties

A substantial number of nonresident foreign nationals in the U.S. come from the countries of China and India. Their tax treaties with the U.S. are illustrative of the problem of subjugating nonresident foreign nationals to state taxation laws. According to treasury regulations, these treaties were patterned after the U.N. Model Convention on Double Taxation. Though the regulations themselves may not be binding on foreign nationals, they are persuasive in providing guidance as to their origin under U.S. Law.

The taxes covered by the model convention "apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied [emphasis mine]." The U.S. tax treaties with these countries (and perhaps all) are completely devoid of reference to the several states. They are devoid of any language indicating that the treaty departs from the model double taxation convention. This, taken together with a constitutional prohibition on states entering into treaties themselves and the basic premise of the treaty- the avoidance of double taxation, lend support to the conclusion that states lack authority to tax nonresident foreign nationals.

The taxes in the China and India treaties include all national and local income tax in those countries. The U.S. taxes covered by the treaty refer only to "federal income tax" or "federal income tax under the Internal Revenue Code." Surely, if states were to be included in the treaty, there would be language within the treaty indicating so. It would also appear to be an obvious necessity given that definitions within the treaty are the only irrefutable terms that apply under U.S. law.

"Au contraire"

The author concedes some legitimacy of the contrarian position that in limiting the language of the treaties to the "federal income tax" there is sufficient implication that state taxes are unaffected. The problem with this position is that it relies on a type of "half glass full" argument. That is to say, that the silence has meaning.

If this were truly the intent of the U.S. in its tax treaties, perhaps it is not guilty of allowing states to illegally impose taxation on nonresident foreign nationals. Rather, it is either guilty of poor draftsmanship (there appears to be no technical reason for the omission), or intentionally "hoodwinking" the other Contracting States who were perhaps unaware of the extent of state taxation in the U.S.

Conclusions

The U.N. Model Convention on Double Taxation formed the basis of most U.S. tax treaties with other Contracting States covering the taxation of nonresident foreign nationals. This model convention defines taxes imposed by the Contracting State to include political subdivisions. The China and India treaties are silent in regard to the taxation of nonresident foreign nationals by the several states.

The tax treaties with those countries refer only to "federal income tax." The several states are constitutionally prohibited from entering into their own treaties. The several states have no authority to tax nonresident foreign nationals. The taxation of nonresident foreign nationals by the several states is a violation of international law.

If the omission of state taxation was intended to exclude state taxation from the treaty, the treaties were exceptionally ill-prepared. The author concludes that the Contracting States of these treaties should amend same to reflect either that state taxation in the U.S. is or is not covered by the respective treaties. The author further concludes that present or past nonresident foreign nationals may have a viable claim to a full refund of any state taxes paid.